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POLITICAL OPTIONS FOR CALIFORNIA 2003

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It was, appropriately, a former Speaker of the California Assembly and State Treasurer, the late Jesse Unruh, who first said, "Money is the mother's milk of politics." This year, the saying resonates again in Sacramento as the largest percentage drop in state revenue since WWII has created a defining moment for political parties, the legislature, a governor, and the State of California. A fiscal shortfall of the magnitude now faced by California eclipses such recent hot political issues as energy, redistricting, secession in Los Angeles, and campaign finance reform.

There are two general categories of public policy options. The first is pleasant, when tax revenues exceed projections, and policy makers get to choose which programs to create or expand. The second is miserable, when revenues don't meet projections, legislatures don't authorize tax increases, and policy-makers must choose what must be cut or eliminated. California, for the second time in twenty years, and after a decade of pleasant policy choices, is entering a period of public policy misery.

California's current budget dilemma is due to an economic downturn led by the deflation of the dot-com industry, an accompanying drop in taxable income from stock options and capital gains, and deficit spending even at the peak of the business cycle.¹ Add to that the energy pricing fiasco of 2001, which left the state with expensive long-term power contracts, plus a post 9-11 downturn in the tourism and entertainment industries, and it is not likely that misery will be leaving soon.

Minus the state budget crisis, this chapter would largely be concerned with the residue of the energy contract agreements and lawsuits, crime and prison construction, and the difficulty of filling senior positions in state government--all of which, important as they are, have become sidebar stories to the larger fiscal crisis.

The earliest signs of the shifts in state fortunes first appeared on the public radar in the early fall of 2001, after the state entered long-term borrowing to offset the energy crisis. In the uncertain days following September 11, Governor Gray Davis directed all state department directors to produce plans for 15 percent reductions in their budgets. Shortly after that the California Legislative Analyst's Office began predicting up to fifteen percent reductions in state revenue--roughly \$12 billion.² Since that time, deficit estimates have gone as high as \$30 billion (depending on how and what is counted, as Dan Mitchell and Werner Hirsch point out in the next chapter). In terms of policy choices, such a deficit will be devastating for publicly funded services. And political, it will exacerbate the stark divisions between rich and poor, conservative and liberal, urban and rural; between those who have no trust in government and those who depend on it. In short, the deficit promises to test the sustainability of 25 years of anti-tax referendum mandates and what strength remains for government to lead.

As Sacramento Bee editor Peter Schrag wrote in his 1998 book *Paradise Lost; California's Experience, America's Future*, "... when funds run low or programs have to be cut, it is nearly impossible to determine whether accountability rests with the state's elected politicians for not providing enough or with the local board for spending it wastefully." Something similar is true for county governments. Since spending is so hopelessly tangled into formulas that have been written into the constitution--directly by measures like Proposition 98, which established mandatory minimum state funding requirements for schools; indirectly by a three-strikes initiative that threatens to devour a large part of the state's discretionary funds in escalating prison costs--the system runs largely on autopilot, beyond the control of any elected official. The whole fiscal system, in the view of Elizabeth Hill, California's non-partisan legislative analyst, has become 'dysfunctional.' It "does not work together to achieve the public's goals."³

Part of the problem is that the public's goals in California are not clear. This state, like much of the country, is characterized by what Jean Ross of the watchdog group, the California Budget Project, calls "diversity and division."⁴ California has become a demographic patchwork, with multicultural Latino and Asian populations and with growing populations of the young and old. The liberal legacies of governors Brown to Davis exist alongside Reagan-Wilson conservatism. The level of partisanship in state government remains very high: in this last budget cycle the anti-tax Republican minority was effectively resolute in 2002 in controlling its membership to withhold the four Republican votes necessary for a budget to pass the Democrat-controlled Assembly.

Financial crises, however, occasionally have a way of mobilizing majorities toward strong responses. The Great Depression mobilized a liberal response of public spending and borrowing that built public works projects, schools, universities and income and health safety nets. The recessions of the last quarter century mobilized majorities to limit and cut taxes, downsized the government, and curtail capital and social spending. Which approach works? Interestingly, after almost a century proponents on both sides have good arguments that their approaches are the most economically stimulating and that the other side is at best, short-sighted and misguided.

In the absence of debilitating crisis or charismatic leadership, however, a third path, through the thickets of division and diversity, seems likely--if wholly unsatisfying to all sides--and that is to struggle through budget season after budget season, compromising middle-ground solutions though surpluses and deficits, satisfying least common denominators between services and tax cuts, at each stage along the way.

Round One: The Band-Aid

In September 2002, well past the constitutional deadline for budget enactment, the Democrats in the Legislature with a necessary and symbolically minimum number of Republicans, who had to break the no-new-taxes-cut-government-spending dogma of their party, produced a new budget for fiscal year 2002-03.

It was, by all accounts, a barely adequate, short-term response to the crisis; but it played out as could be expected for a deficit that appeared at the end of a governor's first

term as he campaigned for a second. It is the governor who is constitutionally bound to present a budget to the legislature for revisions and approval. Any governor intent on re-election would naturally be inclined to put off politically suicidal choices between deep cuts in services and significant hikes in taxes and fees.

Governor Davis, following this rationale, did everything he could to avoid the difficult choices, and the legislature, dominated by sympathetic Democrats, supported him. The thinking in Sacramento is that the next fiscal year will be less politically volatile and the governor and the legislature will have more freedom to make both cuts and hikes. And with some luck, the California economy will rebound, even slightly, generating more tax revenue at existing rates. However, a cash crisis for the state could force adjustments before June 30, 2003.

In the meantime, however, the deficit-driven budget delivers interesting indicators of the priorities and political policy choices faced by California, in the coming rounds of deficit budgets.

Education

Public education at all levels in California has serious problems. These include declining investment in education, stress and mediocrity in the teaching profession, overcrowded classrooms, deteriorating buildings, an increasing proportion of under-prepared students, increasing racial and cultural tensions, increasing violence in communities and schools, declining parent and community support, and --not surprisingly--a consequential drop in student performance. While the increased state revenues of the mid-to late nineties allowed the state to increase spending on education significantly, public schools, colleges and universities have already begun to feel the ebb in revenue.

K-12 Education

California K-12 education spending has been driven over the past thirty years by a wide range of court decisions, referendum measures, and legislative actions that have resulted, in varying degrees, in limiting, increasing and equalizing spending on education.

The modern era of education spending legislation began in 1976 with a California Supreme Court decision, *Serrano v. Priest*, which ruled that the existing system of financing was unconstitutional, and that property tax rates and per pupil expenditures would have to be equalized. Since *Serrano*, the state has attempted to create a more level funding system, which has brought nearly 98% of the state's students into the "equalization" band (within \$354 of the statewide average).⁵

Two major ballot propositions have also driven state support for education. The first was Proposition 13, passed in 1978, which limits what the government can collect in property taxes, the traditional means of funding education. The second was Proposition 98 passed in 1988, partially in reaction to the decline in school quality after Proposition 13. Proposition 98 requires schools, from kindergarten through community colleges, to

receive a large share of any increase in state revenues.

Serrano and Proposition 13 transformed the role of the legislature largely from policy maker to inventor of acceptable funding formulas, which are often highly complex, to meet referendum and court orders, which are often simple and direct. Also, as a result of *Serrano* and Proposition 13, schools are essentially reliant on the state's economy as their major source of income, subjecting funding to dramatic fluctuations through booms and busts. Beyond devising funding formulas the legislature has had few major initiatives of its own, but those, especially limiting class size and allowing charter schools, have been significant.

Proposition 98, strong political support for schools, and a robust state economy have lead to unprecedented higher spending on education. In the bull market years of the 1990s, education spending increased by 23 percent. Following this increased spending, evidence from standardized test scores and parent satisfaction surveys indicate that California schools are improving. In this cycle, at least, the governor and the legislature have protected the education increases, making only \$850 million in Proposition 98 deferrals, affecting such programs as school bus safety, performance awards, energy grants, and high priority schools, out of a \$45 million allocation from state funds and local property taxes.⁶

In terms of current policy choices, there is a feeling that California has started to regain some lost ground on school support and performance. The governor has been explicit in his desire to protect education spending during budget cuts. A good indicator of public confidence in the education system was seen in the passage of Proposition 47 on the November ballot which authorizes the state to issue \$13.5 billion in general obligation bonds for school facility improvement.

Higher Education

Higher education policy in California has to be understood in the light of the 1960 Master Plan for Education, which provided that, tuition free, the top ten percent of high school seniors would be eligible for the University of California, the top one third would be eligible for California State University, and all would be eligible to attend their local community college. Public higher education would be funded primarily from the state's general fund with nominal fees to students for specific services. Post-Proposition 13, however, the university went from having over 70 percent of its budget provided by the state to, now, less than 25 percent. The financial crunch of the early nineties further severely damaged the master plan vision. Fees doubled. Student-faculty ratios declined. Classes taught by part-time lecturers increased. At the same time, however, the state, in the legislature, has retained to authority to set policy and fees, which doubled from \$2000 to \$4000 in the early nineties.⁷

Even though the current budget only calls for a 3.5 percent decrease in general funds support for the UC system, it is expected that the current crisis will hit the California Higher Education system hard. Campuses have been asked to plan for 20 percent cuts. The economic downturn has had a strong adverse effect of private

philanthropy and most foundation endowments. Grants and contracts are harder to find and still harder to negotiate. Since tenured faculty salaries and positions are untouchable, the cuts will come in staff, services, and deferred maintenance. The Legislative Analyst, however, has pointed out that California university and college fees are still significantly below the national average, and has recommended that professional schools have more flexibility in charging fees, among other measures.⁸

At the state level, the shifting demographics of the legislature and the higher turnover rate caused by term limits have restacked priorities toward community college and technical and vocational education, and away from the universities, which are seen to have alumni donor and research funding sources. The governor and the legislature will be revisiting the fee structures (which have been very unpopular politically) and once again trying to pressure campuses to shed outmoded departments and programs.

And on the horizon, lawmakers and education officials have been writing a new Master Plan for Education, which will include all programs from kindergarten through university. The major reform of the plan for K-12 education will be to place more power in the hands of the governor on education issues. For higher education, the current draft reiterates the distribution of access and calls for more flexibility and creativity in achieving diversity goals, providing for special needs of students, and hiring and employing faculty. It includes many controversial ideas such as proficiency examinations for college graduation. The draft master plan is now circulating in the legislature, and will be debated in the next year.⁹

The Environment

Environmental activists were pleased and automakers chagrined this past year when Governor Davis signed a bill directing state air regulators to enact measures by 2009 to cut vehicle emissions of carbon dioxide and hydrofluorocarbons.¹⁰ The bill, which is unspecific on how or how much, is seen as monumental as it makes California the first state to force auto makers to curb greenhouse-gas emissions from vehicles. American automakers, however, have already begun a campaign against the measure, which they lobbied heavily against in the legislature, and are considering developing a ballot referendum question. California accounts for 13 percent of US car sales, and past California regulations have led such national requirements as unleaded gasoline, fume blockers on gas pumps and catalytic converters in cars. California is the only state allowed by federal law to increase air quality standards; other states can only follow California's lead. The debate on how to cut greenhouse gas emissions, and by how much to cut them, promises to be contentious and serious. The Federal government, which in the past has granted special allowance to California to pioneer aggressive environmental protection measures on emissions, is likely to reverse its course under a more conservative Environmental Protection Agency and court appointed by President Bush, making it harder to support and fund the measure.

Water

California is prone to drought, and there's one developing rapidly. According to the California Association of Water Agencies, in average years about 193 million acre-

feet (MAF) of rain and snow fall on California. One acre-foot is about 326,000 gallons, or enough water to supply two typical families for a year. More than 100 million acre-feet of the rain and snow received soak into the ground, evaporate or is used by native vegetation. That leaves about 71 million acre-feet of usable surface water. Of that water: 36 percent flows out to the ocean; 28 percent is legally committed to wild and scenic rivers and San Francisco Bay-Delta outflow; 28 percent is used by agriculture; and 7 percent is used by cities and industry.¹¹

Southern California just logged its driest year on record. Rainfall in Los Angeles and San Diego was less than a third of normal for the water year that ended June 30. Some areas received even less. But despite the bone-dry conditions, most Southern Californians will receive full or nearly full water supplies this year, but a deepening drought in the Colorado River basin is prompting concerns over possible shortages in that supply next year. Five of the seven Colorado River basin states have declared drought emergencies or requested federal drought assistance. Inflow into Lake Powell is just 30% of average, and storage in Powell and Lake Mead is expected to be just 61% of capacity by the end of the year.

In the current budget, however, the governor cut about \$15 million from CALFed, a multi-budget coalition of state and federal agencies that manage the state's water. Cut significantly were ecosystem restoration projects, water use efficiency, watershed management, levee construction, and water storage.¹²

Human Services

In January 2003, California welfare recipients who have received five years of cumulative payments will be ineligible to receive assistance. This will be the first true test of the 1996 federal welfare reform act and the subsequent 1998 state welfare reconfiguration. Since welfare reform, which was enacted during a period of economic growth and low unemployment, the state welfare rolls dropped from 903,000 households to 488,000. But as many as 114,000 recipients face the January cut-off and the number is expected to grow by about 12,000 a month after that. Payments for adults will cease, but families will continue to receive cash benefits for children as well as maintain eligibility for Medi-Cal assistance and food stamps. An average family of three, for instance, will have its monthly grant cut from \$430 to \$300.¹³

Groups expected to be hardest hit include recent Asian and Eastern European immigrants who lack English language skills, and chronically-unemployed adults who are illiterate, functionally incompetent, or suffer from mental illness and substance abuse. A significant percentage, served by the California Work Opportunity and responsibility to Kids (CalWORKS) program, will consist of families who are employed in low-wage jobs that have still required assistance to pay for basic necessities of rent and food.

In terms of the current state budget, human services, mental health, and welfare-to-work programs were among the most severely cut programs.¹⁴ The state reduced spending for health and human services programs by \$177 million, which represents 75 percent of the \$235 million directly cut from the previous year's general fund allocations.

The governor cut \$143 million to expand the Healthy Families Program to include parents of eligible children; reduced funding for Medi-Cal county administration by \$58 million; eliminated \$12 million in Medi-Cal eligibility for children enrolled in the National School Lunch Program; deleted \$22 million to fund a two-month "bridge" for children transitioning from Medi-Cal to the Healthy Families Program; deleted \$5.4 million by shifting a 10-percent share of cost for growth in the Early and Periodic Screening, Diagnosis, and Treatment Program to counties; and reduced funding for trauma system providers by \$5 million.

In mental health services, the state reduced funding for children's mental health services by \$14 million; deleted \$2 million by eliminating state funding for Adult Systems of Care in Mental Health Services; and reduced funding for the Integrated Services for Homeless Adults program by \$10 million. In addition, the governor deleted a \$5.6 million legislative augmentation for one-time grants to develop community resources for the developmentally disabled.

For CalWORKS, the governor reduced funding for adult education by \$23 million leaving \$9.9 million in Temporary Assistance for Needy Families (TANF) funds for adult education to CalWORKs recipients. Supportive services for CalWORKs community college students were also cut by \$9 million.

In addition, county administration for the Food Stamp Program was cut by \$16.5 million, and the final budget assumes that counties will pay \$104.2 million of a \$115.8 million federal penalty for food stamp errors in 2001. Finally, Child Welfare Services lost \$49.5 million and adoptions programs were cut by \$5.2 million.

On the Federal level, the US Congress is considering different approaches to the reauthorization of the Temporary Assistance for Needy Families program, the outcome of which could have a drastic effect on California's budget. The Legislative Analyst estimates that over the next five years net state costs would be about \$2.2 billion for the more conservative House version, and \$140 million for the version passed by the Senate Finance Committee. The bill was in conference in September 2002.¹⁵

Housing

Housing in California faces a crisis of affordability, not supply. Median home prices, which reached levels of absurdity in Northern California during the Silicon Valley boom, have continued to rise through the economic downturn. Rents have also continued to rise. California voters expressed their awareness of the affordability problem by passing Proposition 46 in the November election, which will allow the state to sell \$2.1 billion of general obligation bonds to fund 21 housing programs. According to the Legislative Analyst, about 150,000 houses and apartments are built in California each year. Portions of these receive state funds, low-interest loans or grants to developers. Typically, there is a requirement that the housing be sold or rented to Californians with low incomes. In 1988 and 1990, voters approved \$600 million of general obligation bonds to fund state housing programs, which have now been spent. Since that time, the state typically has spent less than \$20 million annually on state housing programs. The

major allocations of the \$2.1 bond proceeds will be to multifamily housing programs (\$1.11 billion); homeownership programs (\$405 million); farmworkers' housing (\$200 million) and additional funds would be allocated for the construction of homeless shelters, payments to cities and counties, provision of mortgage insurance for high-risk homebuyers, and for capital needs of local code enforcement departments.¹⁶

Transportation

California's highways are now the third most deteriorated roadways in the nation. Our cities, particularly Los Angeles, are notorious for limited public transportation access, and the number of drivers and cars, particularly SUVs, on the highways continues to rise dramatically. The major policy choice for California in transportation this year came with the adoption of Proposition 42 in the March election, which mainly provides new revenue to cities and counties for filling potholes and repaving city streets and county roads. It is significant as it requires the gasoline sales tax -- a tax already paid at the pump -- to be used to improve highways, local roads and, to a limited degree, mass transit, representing the use of referendum questions to link taxes directly to related services, instead of the general fund.

Mass transit did get a boost in September when the governor signed legislation that puts before voters in 2004 a \$9.95 billion high-speed rail bond measure, which, if passed, promises a train that could carry passengers from downtown San Francisco to Los Angeles' Union Station in 2 hours and 14 minutes, at speeds as fast as 220 mph. The bonds would be a down payment on a 700-mile electric train network that would stretch from Sacramento to San Diego. Most of the money -- \$9 billion -- would help pay for construction of the initial \$13.7 billion line connecting Los Angeles, Bakersfield, Fresno, San Jose and San Francisco. Later links would include Sacramento, Oakland, Merced, the Inland Empire and San Diego. The measure designates the rest of the bond money -- almost \$1 billion -- for improving light rail and inner city passenger systems.¹⁷

Anti-Terrorism

After September 11, 2001, security activities became a concern for California state government. Questions of responsibility, jurisdiction, cooperation, and collaboration have been difficult. Who should guard from terrorists the Golden Gate Bridge, LAX, or privately owned nuclear power plants that supply public energy? Who should pay for that security? So far, the responsibility for paying for only some new security measures has been assumed by the federal government in post 9-11 allocations. But many anti-terrorism costs will fall on state and local governments and the private sector.

California expects to receive a total of \$50 million in federal funds to offset the costs of anti-terrorism security activities. The lead agency receiving these funds has turned out to be the California Highway Patrol (CHP). The most recent governor's budget proposed a total of \$96.2 million for specific measures to enhance security programs, of which \$89.6 million (93 percent) goes to CHP.

Among the new measures now allocated by CHP to anti-terrorism: 100 officers to operate the state's 18 truck inspection facilities 24 hours a day; 50 officers assigned to

inspect carriers of hazardous materials; 40 officers to provide security for nine major bridges and the Trans Bay Terminal in San Francisco; 33 officers for the state capitol and state office buildings and facilities; 24 officers to operate five new helicopters for aerial patrols; 18 officers to patrol nuclear power plants and state health laboratories; and \$23 million for staff overtime in the event of tactical alerts, and \$2.5 million for equipment to protect officers against chemical weapons. In addition Caltrans will spend about \$24 million from the state highway account to install additional surveillance cameras, fences, gates, and locks on the state's toll bridges. And these are just a few of the new measures, which may or may not be permanent, and may or may not be funded primarily by the federal government in the future.¹⁸

Conclusion

California government is in for hard times, and it may not have the political wherewithal to solve the myriad complex responsibilities before it. California's political and policy landscape is still defined by Proposition 13. As Dan Walters of the *Sacramento Bee* has written, Proposition 13 "changed the political dynamics of the state in dramatic and lasting ways. It marked the end of a three-decade-long period of expansive government that had even survived Ronald Reagan's governorship. Inadvertently, it led to a massive shift of financial and operational authority from locally elected government and school officials to Sacramento. It altered land-use policies of local governments and they sought to maximize commercial sales tax-producing projects. And most of all, it made opposition to new taxes a very strong tenet, virtually a litmus test, of California politics."¹⁹

Against this backdrop, California government is facing one of the most severe fiscal tests in its history. The Governor and the Legislature have, as a first reaction, put off the most difficult decisions for a not too distant future date. In terms of priorities, there is a strong sentiment to protect education and public safety, which includes policing, prisons, and anti-terrorism activities. The agencies dealing with the largest cuts are in health and human services. Environmental, water, and transportation and infrastructure initiatives will be slowed considerably as the state scrambles to pay for a wide range of projects and referendum demands by California's voters.

Endnotes

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